Rev. Rul. 66-149, 1966-1 C.B. 146

A social club is not exempt from Federal income tax as an organization described in section 501(c)(7) of the Internal Revenue Code of 1954 where it regularly derives a substantial part of its income from nonmember sources such as, for example, dividends and interest on investments which it owns. However, a club's right to exemption under section 501(c)(7) of the Code is not affected by the fact that for a relatively short period a substantial part of its income is derived from investment of the proceeds of the sale of its former clubhouse pending the acquisition of a new home for the club.

I.T. 3302, C.B. 1939-2, 105, superseded.

Advice has been requested whether a social club which regularly receives a substantial part of its income from interest and dividends on investments qualifies for exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954.

The income of the club consists of amounts received from its members in the form of fees, dues, and assessments plus a substantial amount from investments. Any excess of income over expenditures is generally reinvested in income producing assets.

Section 501(c)(7) of the Code provides that clubs organized and operated exclusively for pleasure, recreation and other nonprofitable purposes are exempt from Federal income tax provided no part of the net earnings inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1 of the Income Tax Regulations provides that, in general, the exemption extends to social and recreation clubs which are supported by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified merely because it raises revenue from members through the use of club facilities or in connection with club activities.

The statute contemplates that club falling within the ambit of section 501(c)(7) of the Code are designed primarily to provide for the pleasure and recreation of members. These activities may be supported by funds obtained from members, such as dues, assessments, and payment for the use of club facilities. However, to the extent that income is derived from nonmember sources, it inures to the benefit of the members. If such activities are other than incidental, trivial, or nonrecurrent, it is considered that they are intended to produce income and are reflective of a purpose inconsistent with exemption under section 501(c)(7) of the Code. See Rev. Rul. 58-589, C.B. 1958-2, 266, at 268, and the cases cited therein.

This case is distinguishable from that described in I.T.

3302, C.B. 1939-2, 105, where it was held that a social club's exemption from Federal income tax was not affected by the fact that, for the time being, a substantial part of its income was derived from interest. There, the investment was found to be not made for profit, but incidental to the acquisition of new club facilities following the sale of its old club-house for reasons found not to have been motivated by profit.

Such situation does not prevail in the instant case. Here the club's funds are invested primarily for the purpose of producing income through dividends, interest, or capital appreciation. It is evident (1) that such income is regularly derived from nonmember sources, (2) that the income is received in fulfillment of and pursuant to a profit motive, and (3) that the income from investments is substantial in relation to total income. Furthermore, as stated in Revenue Ruling 58-589, above, net earnings inure to members through an increase in services offered by the club, without a corresponding increase in dues, or through an increase in the amount which would be distributed upon dissolution of the club.

Accordingly, a social club is not exempt from Federal income tax as an organization described in section 501(c)(7) of the Code where it regularly derives a substantial part of its income from nonmember sources such as, for example, dividends and interest on investments which it owns. However, a club's right to exemption under section 501(c)(7) of the Code is not affected by the fact that for a relatively short period a substantial part of its income is derived from investment of the proceeds of the sale of its former clubhouse pending the acquisition of a new home for the club.

I.T. 3302, C.B. 1939-2, 105, is superseded.